

Message Text

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ACTION TRSE-00

INFO OCT-01 EUR-25 ADP-00 L-03 TAR-02 AID-20 EB-11 NSC-10

RSC-01 CIEP-02 SS-15 STR-08 OMB-01 CEA-02 CIAE-00

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E. O. 11652: N/ A

TAGS: ETRD IT EEC

SUBJECT: TRADE REFORM ACT OF 1973: TAXATION OF US INVESTMENTS
IN MEZZOGIORNO

1. SUMMARY. US TREASURY PROPOSAL TO TAX ON CURRENT BASIS EARNINGS ON US INVESTMENTS RECEIVING TAX HOLIDAY BENEFITS WILL NULLIFY TAX INCENTIVES FOR INVESTMENT IN ITALY' S MEZZOGIORNO. WE HAVE STRONG IMPRESSION THAT GOI PROGRAM DOES AFFECT DECISION WHERE TO LOCATE IN ITALY OR IN EUROPE, BUT DO NOT BELIEVE IT IS STRONG ENOUGH INCENTIVE TO ATTRACT INVESTMENT TO ITALY THAT WOULD OTHERWISE HAVE BEEN MADE IN US. WE EXPECT STRONGLY NEGATIVE GOI REACTION. WASHINGTON REQUESTED PROVIDE GUIDANCE, PARTICULARLY IN VIEW AMBASSADOR' S MAJOR ADDRESS TO AMERICAN CHAMBER OF COMMERCE IN MILAN MAY 14. END SUMMARY.

2. AMBASSADOR VOLPE WILL MAKE HIS FIRST MAJOR ADDRESS ON ECONOMIC SUBJECT TO THE AMERICAN CHAMBER OF COMMERCE IN ITALY AS CHAMBER' S ANNUAL MEETING IN MILAN ON MAY 14. CHAMBER IS BY FAR MOST IMPORTANT ORGANIZATION REPRESENTING AMERICAN BUSINESS INTERESTS IN ITALY.

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3. THUS FAR, AND TO OUR SURPRISE, WE HAVE RECEIVED NO QUESTION OR COMMENT FROM EITHER US BUSINESS COMMUNITY OR FROM ITALIAN GOVERNMENT REGARDING THE EFFECTS ON ITALY AND ON MEZZOGIORNO OF US TREASURY RECOMMENDATIONS FOR CHANGES IN TAXATION OF FOREIGN

SOURCE INCOME WHICH ARE ATTACHED TO THE DRAFT TRADE REFORM ACT OF 1973. AS WASHINGTON IS AWARE, TREASURY RECOMMENDS THAT EARNINGS FROM US FOREIGN INVESTMENTS WHICH BENEFIT FROM FOREIGN TAX HOLIDAY OR SIMILAR INCENTIVES BE TAXED ON A CURRENT BASIS EVEN WHEN THESE EARNINGS ARE NOT REPATRIATED. IT IS NOT UNLIKELY THAT THIS QUESTION WILL BE RAISED DURING MILAN VISIT AND AMBASSADOR DESIRES TO BE ABLE TO RESPOND TO QUESTIONS.

4. THE MAJOR TAX INCENTIVE OFFERED FOR INVESTMENT IN MEZZOGIORNO IS A 10- YEAR TOTAL EXEMPTION FROM INCOME TAX RUNNING FROM THE FIRST FISCAL YEAR IN WHICH THE CONCERN MAKES A PROFIT. IN ADDITION, FOREIGN COMPANIES ENJOY TAX EXEMPTION UP TO 50 PERCENT FOR PROFITS WHICH ARE DIRECTLY REINVESTED IN ELIGIBLE PROJECTS (E. G. INDUSTRIAL PLANT IN THE SOUTH). FINALLY, NEW COMPANIES RECEIVE A 10- YEAR EXEMPTION FROM THE 98 PERCENT TAX ON CAPITAL AND THE 18.75 PERCENT TAX ON PROFITS IN EXCESS OF 6 PERCENT OF CAPITAL.

5. TREASURY RECOMMENDATIONS WOULD COMPLETELY OFFSET THESE TAX INCENTIVES. (ALSO, THEY WOULD LEAVE ITALIAN TREASURY WORSE OFF THAN IF BOTH US AND ITALY TAXED ON A CURRENT BASIS. DURING THE 10- YEAR EXEMPTION PERIOD THE ITALIAN TREASURY WOULD RECEIVE NO REVENUES, AND THE US WOULD COLLECT THE FULL 48 PERCENT US CORPORATE INCOME TAX.) EMBASSY UNDERSTANDS MOTIVATION BEHIND TREASURY RECOMMENDATIONS: TO REDUCE INVESTMENT OUTFLOWS AND DISTORTIONS OF INVESTMENT DECISIONS STIMULATED BY TAX HOLIDAYS. IN CASE OF ITALY WE OFFER FOLLOWING COMMENTS:

A. ITALIAN TAX INCENTIVES ARE NOT DESIGNED SOLELY TO ATTRACT FOREIGN INVESTMENT SINCE THEY APPLY TO DOMESTIC INVESTMENT AS WELL. WHILE CURRENT TAXATION BY US WOULD EQUATE US TAX TREATMENT OF US FIRMS IN US AND IN ITALY, THEY WOULD ALSO HAVE EFFECT OF PLACING US FIRMS IN ITALY AT LOCAL TAX DISADVANTAGE BOTH VIS- A- VIS ITALIAN FIRMS AND VIS- A- VIS OTHER FOREIGN FIRMS.

B. WE HAVE THE STRONG IMPRESSION THAT, GENERALLY SPEAKING, THE REGIONAL INCENTIVES FOR THE MEZZOGIORNO DO NOT DRAW INVESTMENT FROM THE US. ON BASIS VERY LIMITED STATISTICS, WE ESTIMATE THAT AT LEAST 75 PERCENT OF US INVESTMENT IN ITALY DURING PERIOD SINCE LIMITED OFFICIAL USE
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1956 WHEN INCENTIVES WENT INTO EFFECT TOOK PLACE OUTSIDE THIS REGION AND LARGEST INVESTMENTS IN SOUTH (IN PETROLEUM) WERE MADE IN EARLY YEARS OF THIS PERIOD. DURING 4- YEAR PERIOD 1969-72 ONLY 1 PERCENT OF IDENTIFIABLE US INVESTMENTS WHICH WERE AUTHORIZED UNDER ARTICLE 1 OF 1956 INVESTMENT LAW WERE MADE IN SOUTH. BACKWARDNESS OF AREA AND IN PARTICULAR POOR INFRASTRUCTURE (SEE ROME A-230 FOR RECENT DEVELOPMENT) PROVIDE STRONG OFFSETS TO TAX INCENTIVES, AND BUSINESS EXPERIENCE THERE HAS BEEN DISTINCTLY MIXED.

C. US BUSINESSMEN IN MEZZOGIORNO HAVE NEVER CITED TO US THE TAX INCENTIVE AS REASON FOR DECISION INVESTING OUTSIDE US. GENERALLY THEIR CHOICE IS BETWEEN LOCATING THERE OR IN NORTHERN ITALY, OR OCCASIONALLY ELSEWHERE IN EUROPE. SOME US BUSINESSMEN HAVE COMMENTED THAT TAX INCENTIVES HAVE PERMITTED THEM TO BE GOOD

CORPORATE CITIZENS, I. E. SATISFY ITALIAN NATIONAL OBJECTIVE OF INVESTMENT IN MEZZOGIORNO FOR SOCIAL REASONS AT ACCEPTABLE ECONOMIC PRICE.

D. THE SHARP DISPARITY BETWEEN NORTH AND SOUTH IN INCOME AND OUTPUT PROBLEM HAS BEEN SERIOUS, INTRACTABLE POLITICAL PROBLEM FOR ALL ITALIAN GOVERNMENTS IN POSTWAR PERIOD. IT IS THE MOST SEVER INTERNAL DISPARITY IN EUROPE. THE MEZZOGIORNO CONTAINS THE POOREST PEOPLE IN THE COMMUNITY WHILE THE MILAN- TURIN- GENOVA TRIANGLE WITH DOUBLE THE PER CAPITA OUTPUT IS NEAR OR AT THE COMMUNITY AVERAGE. THE STRAINS CREATED BY THIS CONTRAST ARE A CONTINUING POLITICAL ISSUE. FOR EXAMPLE, ONE ISSUE IN LABOR UNREST IS UNION CHARGES THAT GOVERNMENT NOT DOING ENOUGH ON DISPARITIES ISSUE.

6. WE WISH TO MAKE IT VERY CLEAR THAT WHEN ITALIANS FINALLY TAKE NOTICE OF OUR INTENT, THEY WILL REACT STRONGLY, NOT ONLY BECAUSE THEY WANT US INVESTMENT IN MEZZOGIORNO BUT ALSO BECAUSE OF WIDER IMPLICATIONS US DESIRE TO REDUCE OR ELIMINATE ALL SUCH INCENTIVES WOULD HAVE FOR ITALIANS AND EC REGIONAL POLICY.

7. ACTION REQUESTED: (1) WE EXPECT THAT TREASURY RECOMMENDATIONS WERE RAISED BY ANDREOTTI PARTY DURING WASHINGTON VISIT. REQUEST WE BE PROVIDED TELEGRAPHIC SUMMARY ANY DISCUSSIONS. (2) WHILE WE REALIZE THAT LEGISLATION IS STILL IN DRAFTING STAGE, REQUEST ANY GUIDANCE THAT CAN BE GIVEN ON FOLLOWING POINTS WHICH BOTH US INTERESTS AND GOI ARE LIKELY TO RAISE:

- A. WHAT ARE PROSPECTS FOR AND TIMING OF PASSAGE OF PROPOSAL?
 - B. HOW MUCH FLEXIBILITY WILL THERE BE IN THE PROGRAM?
 - C. CAN ITALY GET AN EXCEPTION FOR THE MEZZOGIORNO?
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D. DO TREASURY PROPOSALS, IN FACT, REFLECT US OBJECTION TO USE OF TAX INCENTIVES IN IMPLEMENTING REGIONAL POLICIES? VOLPE

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